

# REPORTS ON OBSERVANCE OF STANDARDS AND CODES

## ETHIOPIA

### ACCOUNTING AND AUDITING

November 2007

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#### Executive Summary

The Government of Ethiopia is committed to increasing private investment in its economy towards reaching its development and growth objectives. Strengthening the country's financial architecture will make available quality financial information to facilitate investment decisions and to help reduce the risk of financial crises and corporate failures together with their associated negative economic impacts that have been witnessed in many industrialized and developing countries.

This report is based on a review of corporate sector accounting, auditing, and financial reporting practices and supporting infrastructure in Ethiopia. The review revealed areas requiring improvement. There is no requirement for compliance with accounting and auditing standards both in the Commercial Code 1960 and other laws and regulations for specific sector entities. Some laws require compliance with generally accepted accounting principles and generally accepted auditing standards, but these terms are not defined. The Ethiopian Professional Association of Accountants and Auditors (EPAAA) is not a professional certification or regulatory body, does not have legal backing and is not a member of the International Federation of Accountants (IFAC). The Office of the Federal Auditor General (OFAG) regulates the accountancy profession but has other broader responsibilities. There is no quality review of auditors' work and no local legal requirement for auditors to have professional indemnity insurance. There is no local professional accountancy qualification. Enforcement mechanisms of financial reporting requirements are nonexistent because of lack of capacity in regulatory institutions and the absence of penalties in the regulations.

The following policy recommendations made in this report require a holistic, multi-disciplinary approach for implementation:

- Revise the Commercial Code 1960 and the other relevant laws and regulations.
- Enact a financial reporting law.
- Establish a National Accountants and Auditors Board.
- Set accounting standards
- Mandate International Standards on Auditing (ISA) for all auditors.
- Establish a strong accountancy professional body, with IFAC membership.
- Establish a local professional and technician accountancy qualification.
- Enhance the capacity of all regulators to enable them to effectively discharge their responsibilities and to handle IFRS related issues in the regulation.
- Conduct awareness campaigns and related programs.

Implementation will require the cooperation of a wide range of stakeholder groups and should be championed by a senior Government figure. This report recommends establishment of a National Steering Committee to coordinate the financial reporting and auditing reforms and develop a country action plan. The Government, policymakers, and development partners should work together to secure the resources so as to achieve a strong financial reporting infrastructure in Ethiopia.

## ABBREVIATIONS AND ACRONYMS

AACCSA	Addis Ababa Chamber of Commerce and Sectoral Association
ACCA	Association of Chartered Certified Accountants
ASC	Audit Services Corporation
Br	Birr, the currency of Ethiopia
CPD	Continuous professional development
ECSAFA	Eastern Central and South African Federation of Accountants
ECSC	Ethiopian Civil Service College
EPAAA	Ethiopian Professional Association of Accountants and Auditors
GAAP	Generally accepted accounting principles
GNI	Gross national income
ICAA	Institute for Certifying Accountants and Auditors
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
ISA	International Standards on Auditing
NGO	Nongovernmental organizations
NSC	National Steering Committee
PASDEP	Plan for Accelerated and Sustained Development to End Poverty
OFAG	Office of the Federal Auditor General
ROSC	Reports on Observance of Standards and Codes
SME	Small and medium enterprises

## PREFACE

Reports on Observance of Standards and Codes (ROSC) is a World Bank and IMF joint initiative that helps member countries strengthen their financial systems by improving compliance with internationally recognized standards and codes of best practice. The ROSC was developed following the financial crises of the late 1990s as part of a series of measures to strengthen the international financial architecture. The global financial community considered that the implementation of internationally recognized standards and codes of best practice would provide a framework to strengthen domestic institutions, identify potential vulnerabilities, and improve transparency. Ultimately, the ROSC aims to enhance a country's resilience to shocks and to better support its risk assessment and investment decisions. The ROSC involves 12 key reported areas.<sup>1</sup>

A ROSC Accounting and Auditing (A&A) review evaluates a country's corporate sector<sup>2</sup> accounting and auditing standards and practices using International Financial Reporting Standards (IFRS)<sup>3</sup> and International Standards on Auditing (ISA)<sup>4</sup> as benchmarks. The review also compares the country's institutions that underpin the accounting and auditing practices with internationally accepted good practices. It focuses on the corporate sector practices, although it recognizes institutional links between this and the public sector practices wherever relevant. The review uses a diagnostic template developed by the World Bank to facilitate collection of data, complemented by findings of an in-country due diligence exercise conducted by the World Bank ROSC A&A team. Following the completion of an A&A review, the country stakeholders, assisted by World Bank staff, develop a country action plan that forms a basis for accountancy reform and development in the country.

In Ethiopia, the ROSC A&A review was conducted from September to November 2007 in consultation with the Ministry of Finance and Economic Development, Ministry of Capacity Building, Ministry of Trade and Industry, Ministry of Justice, Office of the Federal Auditor General, Federal Inland Revenue Authority, National Bank of Ethiopia, Addis Ababa Chamber of Commerce and Sectoral Association, Addis Ababa University, Ethiopian Civil Service College, Ethiopian Professional Association of Accountants and Auditors, Ethiopia Branch Office of Association of Chartered Certified Accountants, audit firms, banks, insurance companies, state-owned enterprises, nongovernmental organizations, accountants, lawyers, and academics.

The World Bank team that conducted the ROSC A&A review in Ethiopia comprised M. Zubaidur Rahman, (Program Manager); Patrick Piker Umah Tete, Senior Financial Management Specialist (Task Leader); Mulat Negash Tegegn, Financial Management Consultant; Evelyn Mwapasa (international consultant); and Tesfaye Alemu (local consultant).

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<sup>1</sup> The 12 ROSC areas are data transparency; fiscal transparency; monetary and financial policy transparency; banking supervision; securities; insurance; payment systems; anti-money laundering and combating financial terrorism; corporate governance; accounting; auditing; and insolvency and creditors rights.

<sup>2</sup> Within this report corporate sector includes state owned enterprises.

<sup>3</sup> Within this report IFRS refers to all accounting standards and related interpretations issued by the International Accounting Standards Board and its predecessor, the International Accounting Standards Committee (IASC). IASC-issued standards are known as International Accounting Standards (IAS). In this report, reference to IFRS also includes IAS.

<sup>4</sup> ISA are issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC).

## I. INTRODUCTION

1. This Report on Observance of Standards and Codes (ROSC) provides a review of the accounting and auditing practices and the institutions underpinning the accounting and auditing environment in the corporate sector in Ethiopia. The review drew on best international practices and makes policy recommendations aimed at improving the quality of financial reporting in the country. There are some notable efforts in Ethiopia aimed at improving the quality of financial information. One is aimed at establishing accounting and auditing standards for the private sector under the auspices of the Office of the Federal Auditor General (OFAG).<sup>1</sup> Another is aimed at improving the capacity for public finance management under the auspices of the Ethiopian Civil Service College (ECSC).<sup>2</sup> Work is also ongoing on revision of the Ethiopian Commercial Code under the auspices of the Ministry of Justice<sup>3</sup>. The aim of this ROSC has been to complement the existing efforts by producing a holistic evaluation of all necessary pillars for a strong financial reporting infrastructure.<sup>4</sup> While this report focuses mainly on corporate sector accounting and auditing, it also recognizes the need to ensure a well coordinated approach to develop (i) accounting and auditing standards; and (ii) education and training systems in accounting and auditing, in the public and private sectors.

2. The Government of Ethiopia is committed to increasing the role of private investment in the economy. This is articulated in the country's second poverty reduction strategy paper.<sup>5</sup> Strong financial reporting infrastructure will support the Government's agenda by providing quality financial information, which will facilitate investment decisions and help to reduce risk of financial crises and corporate failures together with their associated negative economic impacts that have been witnessed in many industrial and developing countries. The intended audience of this report includes the Government officials, key stakeholders, Ethiopia's development partners, and national and international market participants.

3. Ethiopia, one of the world's oldest continuous civilizations, is the second most populous Sub-Saharan African country with 75 million people (Nigeria has 140 million

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<sup>1</sup> A study was spearheaded by OFAG in collaboration with EPAAA under the auspices of the Ministry of Trade and Industry that contracted ACCA in 2005 resulting into a report called titled: Ethiopian Accounting and Auditing Standards Development 'Road Map.' This was financed by a Japanese PHRD Grant in preparation of the World Bank-financed Private Sector Capacity Building Project. The road map focuses mainly on the setting of private sector accounting and auditing standards and developing a monitoring body for the profession called the National Board of Accountants and Auditors. To further this process, and to help implement the road map, a 'bankable' project proposal document is being developed by the Private Sector Development Hub (funded by SIDA) of the Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA). This work is in progress.

<sup>2</sup> The effort in ECSC plans to: (i) develop accounting and auditing standards for the public sector; and (ii) provide professional certification to public sector accountants and auditors. This exercise is being done under an Institute for Certifying Accountants and Auditors (ICAA) which has been established. The ICAA (while currently focusing on the public sector) plans over time to be the professional institution in Ethiopia for accounting and auditing for certifying/regulating accountants and auditors, and setting accounting and auditing standards, for both the public and private sectors). This initiative with the ECSC, is under the Ministry of Capacity Building that is funded by the World Bank under the Public Sector Capacity Building Program Project.

<sup>3</sup> The ROSC team reviewed both the existing Commercial Code and the draft revised Commercial Code and comments there on are documented under the statutory framework section below.

<sup>4</sup> There are six pillars that make up a strong financial reporting infrastructure: statutory framework, profession and ethics, education and training, enforcement mechanisms, accounting standards, and auditing standards.

<sup>5</sup> The Plan for Accelerated and Sustained Development to End Poverty 2005/2006–2009/2010 (PASDEP) states "Recognizing the contribution of the private sector to the overall economic growth and poverty reduction, the Government will pursue every avenue available to accelerate growth and development of the sector."

people) and the seventh largest economy with US\$160 per capita gross national income (GNI).<sup>6</sup> Ethiopia's economy is agricultural based. Agriculture contributes to 46 percent of GNI and more than 80 percent of total export earnings. The main export for the country is coffee, which earns around 50 percent of total export earnings. The current economic conditions in the country are encouraging with remarkable economic growth registered in the three consecutive financial years 2002/2003 to 2005/2006 at rates of 11.9 percent, 10.5 percent and 9.6 percent, respectively. Ethiopia uses both the local Amharic language and English as business languages.<sup>7</sup>

4. Ethiopia's financial service sector has 11 banks (including 1 development bank) with total banking assets of Birr (Br)73.8 billion as at August 31, 2007.<sup>8</sup> All banks in the country are locally owned. Other institutions in the financial services sector include 10 insurance companies and 27 micro financing institutions with a loan book of about Br2 billion (as of June 2006). The National Bank of Ethiopia, the country's central bank, supervises the financial services sector. The country does not have a stock exchange. However, the National Bank of Ethiopia has plans to conduct a feasibility study for establishing a stock exchange under the Financial Sector Capacity Building Project financed by the World Bank.

5. The corporate sector in Ethiopia had 4,943 companies registered with the Central Commercial Register in the Ministry of Trade and Industry as of September 30, 2007. The quoted number of registered companies represents the total of two categories of companies in Ethiopia—share companies and private limited companies. Share companies have at least 5 members, capital of at least Br50,000, and the liability of members is limited to their shareholding. Private limited companies have at least 2 and not more than 50 members and capital of not less than Br15,000, and the liability of members is limited to their contribution. Private limited companies are prohibited by the law from conducting banking, insurance, and such other business.

6. Other significant sectors in the economy of Ethiopia include state-owned enterprises and nongovernmental organizations (NGO). Data regarding the contribution of these sectors to gross national income is not readily available, however its significance to the economy is indicated by banking sector assets of more than 70 percent (as of August 31, 2007) being held by state-owned banks. Among the more than 3,000 NGOs registered (as of September 30, 2007), some own micro financing institutions. State-owned enterprises are supervised by the Privatisation and Public Enterprises Supervising Agency. The NGOs are supervised by line ministries and the Disaster Prevention and Preparedness Agency.

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<sup>6</sup> The six economies in Sub-Saharan Africa larger than Ethiopia, in ascending order, are The Republic of South Africa, Nigeria, Sudan, Angola, Kenya, and Tanzania.

<sup>7</sup> Amharic is the local language, which is popularly spoken. English is also widely taught in schools. University education in accounting and commerce is taught in English, and all laws have an English version.

<sup>8</sup> Ethiopian Birr is the national currency. As at October 18, 2007, the exchange rate was US\$1 equal to Br9.04

## II. INSTITUTIONAL FRAMEWORK

### A. Statutory Framework

7. **The accounting and auditing provisions in the Commercial Code 1960 need to be brought up to date with good international practice.** The Commercial Code makes directors of companies responsible for preparation of financial statements, including consolidated financial statements for group companies, and for ensuring that an audit of the financial statements is conducted. However, the provisions for both preparation and audit of financial statements require improvement. In provisions for preparing financial statements, there is no requirement to comply with accounting standards, and the financial statements required to be produced are only balance sheet and profit and loss account.<sup>9</sup> In provisions for audit, there is no requirement to comply with auditing standards, no specified qualification of auditors,<sup>10</sup> and no audit requirement for private limited companies with 20 or less shareholders;<sup>11</sup> and companies are required to appoint more than one auditor at a time.<sup>12</sup> Another area which needs to be reviewed in the Commercial Code is the issuance of shares to the public. Share companies are allowed to issue shares to the public, but there is no regulation for the issuance of these shares.<sup>13</sup> There is a draft revised Commercial Code but this still requires improvements. For details, Appendix A compares the current Commercial Code with the drafted revised Commercial Code. In the table, good practice in each area is presented for consideration by the relevant authorities.

8. **Public Enterprises Proclamation 25/1992 requires state-owned enterprises to keep books of accounts following generally accepted accounting principles (GAAP).** However, within the Public Enterprises Proclamation, there is no requirement for state-owned enterprises to prepare financial statements in compliance with any defined accounting standards or for their auditors to comply with any defined auditing standards. Without definition, interpretations of GAAP can vary widely. As to audits, the Proclamation states that the provisions on powers, duties, and liability of auditors in the Commercial Code shall apply. The Commercial Code does not require auditors to comply with any defined auditing standards.

9. **The financial reporting requirements of NGOs are contained in the General Guidelines for the Implementation of the National Policy on Disaster Prevention and Management.** There is no guidance for NGOs on the standards to be used in preparation and auditing of their financial statements in the General Guidelines. The regulations require

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<sup>9</sup> In comparison, IFRS require income statement, balance sheet, cash flow statement, and statement of changes in equity or statement of recognized gains and losses.

<sup>10</sup> Qualification would be provided by defining auditors as those holding a practicing license issued in accordance with the country's legislation governing accountancy.

<sup>11</sup> There are two persuasive points calling for audits of all private limited companies. (1) The limited liability status granted to a company is meant to be accompanied by a mechanism of assuring the credibility of the financial affairs of the company. Such mechanism can only be provided through audit. (2) There may be private limited companies which, even though they have less than 20 members, are large enough to be public interest entities.

<sup>12</sup> The requirement would imply that the credibility of one auditor is questioned. However, in practice, only one auditor is appointed. Therefore the usefulness of the requirement is questionable.

<sup>13</sup> Regulating public issue of shares protects the public interest by enabling the detection and rectification of frauds, errors, and omissions before the information goes public. Ideally, regulation requirements would include an audit report on the financial information to be included in the prospectus and registration, and approval of the prospectus, with a regulator, before release to the public.

NGOs to prepare financial statements; have the financial statements audited by chartered accountants; and file annual audited financial statements with their supervising agency, the Disaster Preparedness and Prevention Agency. However the regulations do not provide the NGOs with guidance on standards to be used in preparation and auditing of the financial statements.

10. **There are no extra requirements for banks and insurance companies for preparation of their annual financial statements.** Banks and insurance companies are subject to regulatory laws and directives issued by the National Bank of Ethiopia, but there are no extra requirements in these laws or directives for preparation of annual financial statements. The applicable requirements for preparation of annual financial statements for banks and insurance companies are those provided in the Commercial Code. The Commercial Code has no requirement for compliance with any defined accounting standards. Banks and insurance companies are public interest entities which should be subjected to high standards of financial reporting.

11. **Auditors for banks are required to be approved by the National Bank of Ethiopia.** On an annual basis, banks are required to send selected auditor's name to the National Bank of Ethiopia for the approval of the appointment of bank auditor. This is a legal requirement under Proclamation for Licensing and Supervision of Banking Business No. 84/1994. When approving auditors, the National Bank of Ethiopia ensures that only those auditors licensed by OFAG are approved.

12. **Auditors for insurance companies are not subjected to any additional requirements other than the provisions of the Commercial Code.** The Proclamation for Licensing and Supervision of Insurance Businesses No.86/1994 states that the auditors for insurance companies shall have powers, functions, and duties; and be subject to liabilities and penalties under the Commercial Code. There are no other regulations for auditors of insurance companies.

13. **The Income Tax Law requires taxable income of businesses to be determined on the basis of financial statements prepared according to generally accepted accounting standards.** The Income Tax Proclamation No. 286/2002 states that taxable business income shall be determined per tax period on the basis of the profit and loss account, or income statement, which shall be drawn in compliance with generally accepted accounting standards. The problem in this case is that 'generally accepted accounting standards' is not defined, and there are no accounting standards set or adopted in the country.

14. **The Office of the Federal Auditor General and the Ethiopian Civil Service College have been given some legislative authority for regulating the accountancy profession.** OFAG was established by Proclamation No.68/1997 by which it was set up "to make efforts, in co-operation with concerned organs, to promote and strengthen accounting and auditing professions." OFAG has other broader responsibilities as provided for in the country's Constitution. Article 101 (2) of the Constitution states that "The Auditor General shall audit and inspect the accounts of ministries and other agencies of the Federal Government to ensure that expenditures are properly made for activities carried out during the fiscal year and in accordance with approved allocations and submit his reports thereon to the House of Peoples Representatives." The ECSC was re-established through Council of Ministers Regulations No.121/2006. One of its objectives, as set out in these regulations, is "to formulate standards and certify professionals." The ECSC is also given powers and

duties, “to formulate standards and based on such standards confer professional certification in auditing and accountancy.” For these purposes, the ECSC has established a Institute for Certifying Accountants and Auditors (ICAA). The ECSC already has broader responsibilities of responding to capacity building needs of the civil service.

## **B. The Profession**

15. **The number of professional accountants in Ethiopia is rather low in relation to the size of the economy.** There are an estimated 200 professional accountants in the country. In comparison, Uganda and Ghana, with economies less than Ethiopia, each have more than 1,000 professional accountants. Kenya, whose economy is roughly 1.5 times that of Ethiopia, had 3,000 professional accountants in 2001. Having a shortage of professional accountants means that there are positions in the private and public sector that are filled by persons with lower qualifications.

16. **In the absence of a strong professional body and specifically dedicated institutions, OFAG regulates the accounting profession.** The activities of OFAG in regulating the profession include licensing of all auditors in the country, issuing a Code of Ethics for Professional Accountants, and taking disciplinary measures on proven acts of misconduct by professional accountants. On its part, OFAG, institutionally, is facing effectiveness challenges partly caused by the broad nature of its statutory obligations. A World Bank-conducted needs assessment of OFAG in April 2007 noted that in addition to the very broad nature of OFAG statutory powers and duties, it is short staffed and has insufficient human, institutional, and logistical capacity to meet its statutory obligations. Current funding arrangements pose constraints on OFAG for its effective operations, staff operations, and capacity building.

17. **The Ethiopian Professional Association of Accountants and Auditors (EPAAA), has no legal backing and is not a member of International Federation of Accountants (IFAC).** The EPAAA was founded in 1972. From 1974 until 1992, EPAAA stayed dormant because of an unfavorable political environment.<sup>14</sup> Following a change of government in 1991, EPAAA was revived. Now growing, it has increased its membership from only 10 members in public practice in 1992 to 100 members (30 in public practice) as of September 2007. It has membership in Eastern, Central, and South African Federation of Accountants (ECSAFA).<sup>15</sup> EPAAA’s purpose is to further professional accounting and auditing in Ethiopia. However, EPAAA is still far from being a strong association. It is not a professional certification or regulatory body. It is more like a “voluntary club”, with about 45% of the qualified professional accountants in Ethiopia being members of EPAAA. Two main issues undermine the position of EPAAA. First, EPAAA does not have legal backing in the country’s laws, essential for regulatory responsibilities. Second, EPAAA does not have IFAC membership.<sup>16</sup> IFAC sets standards for member professional bodies through its Statements of Membership Obligations.<sup>17</sup> Through these obligations, member organizations

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<sup>14</sup> From 1974 to 1991, Ethiopia was ruled by a socialist government (the Derg regime), which did not favor private enterprise.

<sup>15</sup> ECSAFA members include professional accountancy bodies of Botswana, Democratic Republic of Congo, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Namibia, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe.

<sup>16</sup> IFAC has 155 members and associates in 118 countries.

<sup>17</sup> The Statements of Membership Obligation cover 7 areas: quality assurance, international education standards, international standards related to practice, IFAC Code of Ethics, International Public Sector Accounting Standards, investigation and discipline, and International Financial Reporting Standards.

use their best endeavors at promoting, incorporating, and implementing accounting and auditing standards, which are comparable to good international practice, as well as monitoring of their members through quality assurance and investigation and disciplinary programs.

18. **There are efforts to establish a National Accountants and Auditors Board (NAAB).** OFAG had earlier carried out a study on ways and measures of developing the accounting and auditing profession and had recommended the establishment of NAAB. In addition in 2005, a study on establishing accounting and auditing standards for the private sector was commissioned under the Ministry of Trade and Industry. The study was called *The Road Map*. Arising from the study's recommendations, OFAG in cooperation with, EPAAA and the Addis Ababa Chamber of Commerce and Sectoral Association (AACCSA) is in the process of setting up a National Accountants and Auditors Board that would set accounting and auditing standards for the private sector. The ROSC team believes this is a step in the right direction and a first step to contribute to a program, which should holistically deal with establishing strong financial reporting infrastructure for the country.<sup>18</sup>

19. **There are efforts by the Ethiopian Civil Service College (through its Institute for Certifying Accountants and Auditors - ICAA) to certify accountants and auditors, focusing initially in the public sector.** The ECSC was initially established in 1995. In the first 10 years of its operations ECSC designed and offered diploma and degree programs in accounting, economics, management, law, and urban development. The ECSC was re-established in 2006 with new focus. The focus is now on special needs of the civil service, including specialized programs that have never been properly offered by other institutions. It has dropped a few diplomas and degrees in accounting, economics, and law, which are available in other colleges and universities. The ECSC has been tasked to undertake certification of accountants and auditors. For this purpose, ECSC has already set up the Institute for Certifying Accountants and Auditors (ICAA) and is designing its programs and operations. Initially this effort was in response to the capacity requirements of the public sector, but it is planned that it will expand to deal with the private sector needs as well. This also, the ROSC team believes, is a useful step in the right direction. But it needs to be well coordinated with the other related initiatives. These various initiatives need to be brought together to holistically deal with establishing strong financial reporting infrastructure for the country.<sup>19</sup>

20. **OFAG issued a Code of Ethics for Professional Accountants in the country in January 2004.** While the Code is tailor made for practice in Ethiopia, it is modeled on the Code of Ethics for Professional Accountants issued by IFAC and the International Organisation of Supreme Audit Institutions (INTOSAI). Since issuing the Code, OFAG has

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<sup>18</sup> The four key milestones proposed in *The Road Map* were (a) establishing a standardsetting mechanism; (b) developing a set of Ethiopian accounting standards; (c) implementing ISA, and (d) instituting an investigatory and disciplinary system for audit quality control. This effort largely deals with accounting standards and auditing standards, two of the six pillars necessary for a country's strong financial reporting infrastructure. This effort needs to be complemented by adequately addressing the other four pillars as well (statutory framework, strong accountancy profession, education and training, and enforcement mechanisms).

<sup>19</sup> ECSC states that ICAA has been established to (a) certify public sector accountants and auditors in Ethiopia in order that they practice the accounting and auditing profession in the public sector abiding by the regulations of the country; (b) make sure the profession is practiced ethically; and (c) set accounting standards for the country, etc. To achieve these broad objectives, the education and training efforts in ICAA need to be complemented by the statutory framework, strong and ethical accountancy profession, accounting and auditing standards, and enforcement mechanisms (the pillars of good financial reporting infrastructure).

investigated a serious complaint, which resulted in disciplinary measures being taken against two auditors. OFAG circulated the resulting disciplinary measures to the profession, regulatory bodies, companies and other institutions that engage auditors.

21. **Ethiopia does not have a quality assurance program for auditors.** A quality assurance program checks the auditors' work at both partner and firm level, and ensures that auditors conduct their duties with outmost professional diligence. The program also identifies areas that become a source of designing training programs to improve the capacity of auditors. Establishing a country-level quality assurance program is an international good practice. Under this program, the professional accountancy body develops quality control standards and relevant guidance, requiring audit firms to establish the quality control policies and procedures necessary to provide reasonable assurance of conforming to professional standards in performing services. To ensure that audit firms have effective quality control arrangements, a mechanism of independent review must be in place. Such a review mechanism does not exist in Ethiopia at the present time.

22. **No legal requirement exists for auditors to have professional indemnity insurance.** Professional indemnity insurance is the means by which assurance is provided that auditors would be able to meet liabilities in the event there are valid claims regarding their professional conduct. Usually, the regulation will make it a condition for granting a license and for license renewal every year. At present, there is no requirement for auditors to have the insurance in order to get a practicing license. This is also an important area to be considered in strengthening the country's financial reporting infrastructure.

23. **The big-four international audit firm networks are not present in the country.** Most of the major international audit firm networks had presence in Ethiopia prior to 1974. When in 1974 the Government changed to a Socialist system, all the international audit firms closed their offices in Ethiopia. Those audit firms have not yet returned to the country although there is no law or regulation which hinders them to operate in Ethiopia. With this situation, the auditing profession in the country may be losing exposure to international expertise.

24. **The country has not yet experienced litigation on financial reporting.** There are no records of litigation dealing with financial reporting. However the ROSC team understands that the country has recorded minor litigation on governance issues; specifically a case to do with director's remuneration was cited by stakeholders in the legal field. As sophistication of the economy increases, increased litigation would be more likely; hence the need for good financial reporting infrastructure as well as overall good corporate governance infrastructure.

### **C. Professional Education and Training**

25. **Locally, there is neither professional accountancy qualifications nor training available for professional accountancy.** All professional accountants hold foreign professional qualifications. The leading professional qualification is Association of Chartered Certified Accountants (ACCA). The ACCA has 192 members (including associates), and 1,300 students in Ethiopia. It is estimated that about 95 percent of the professional accountants in the country hold the ACCA qualification. The ACCA has a branch in Addis Ababa. As for training, there is no institution that provides professional accountancy training. Professional accountants get their qualification through distance

learning. However, the ACCA fees are considered too expensive by the majority of Ethiopians.

26. **Academic accountancy programs are available in universities and colleges.** Some Ethiopian universities and colleges award a Bachelor's degree in accounting. Throughout the country, the Bachelor's degree in accounting follows the same curriculum. Entry into the degree program is very competitive. Qualifying school leavers (Grade 10) undergo a two-year preparatory course for the degree program, after which they must pass an entrance exam. School leavers who do not qualify for the preparatory course for degree program have the option of entering a program to pursue a diploma in accounting. A diploma in accounting, with good grades, qualifies one to sit for entrance exams into the accountancy degree program. The accountancy degree has a good reputation within the Ethiopian market; graduates get employed easily. Holders of the Bachelor's degree in accounting are exempt from five subjects in the ACCA professional program.

27. **The available accounting degrees and diplomas are said to meet the current demands of the business community; however, the curriculum as well as text books may not prepare graduates well for enhanced financial reporting requirements.** Stakeholders indicate general satisfaction with current requirements toward the accounting degrees and diplomas available. However, there are areas that will have to be updated in order to prepare graduates for enhanced requirements in accounting and auditing. The curriculum does not include international components in accounting (IFRS) and auditing (ISA). Professional values and ethics are not taught as a separate subject (as required by IFAC standards on education) although a subject in the curriculum (Civics) covers general ethics. The textbooks in use are not up to date with recent trends in financial reporting.

28. **Higher educational institutions are losing well-qualified instructors because of low pay.** Most of the higher educational institutions in Addis Ababa indicate that they are losing well-qualified and experienced instructors because of more competitive pay from the private sector, NGOs, and other countries. The situation is much worse outside Addis Ababa. Brain drain in universities has the long-term effect of eroding the quality in the education, training, and research capabilities of the country.

29. **There is no locally controlled practical training for accountants.** The absence of a local professional qualification and a strong professional body has contributed to the absence of a local mechanism for monitoring practical training requirements for professional accountants. Controlled practical training is an essential part of professional qualification that feeds into the quality in professional accounting. In order to improve on the quality of professional accountants, a domestic mechanism of ensuring quality control for the profession must be considered, planned, and established.

30. **There is no domestic institution, which monitors and enforces continuous professional development (CPD).** The lack of a strong professional body leaves no domestic mechanisms for monitoring and enforcing continuous professional development. The CPD programs are the means through which professional accountants keep up to date with the local and international developments in accounting and auditing. IFAC requires its member bodies attain CPD hours compulsory for all professional accountants. Continuous professional development feeds into sustaining the quality of professional accounting. The local Ethiopian office of ACCA in conjunction with local institutions, the Federal Inland Revenue Authority, and other accountancy associations regularly organizes seminars

covering tax, governance, financial reporting, and auditing issues. The ACCA courses are the main source of CPD for accountants in the country.

#### **D. Setting Accounting and Auditing Standards**

31. **Except for implication in provisions of the legal mandate of OFAG and ECSC, there is no institution with a specific mandate for setting accounting and auditing standards.** In the case of OFAG, the relevant provisions state its objectives (“make efforts in cooperation with concerned organs to promote and strengthen accounting and auditing professions”) and its powers and duties (“issue directives, in cooperation with other offices concerned, regarding accounts and property auditing procedures and standards”). In the case of ECSC, the relevant provisions state one of the objectives (“to formulate standards and certify professionals”) and one of its powers and duties (“to formulate standards and based on such standards confer professional certification in auditing and accountancy”).

32. **There are no accounting and auditing standards set in Ethiopia.** For accounting standards, there is no law or regulation that has set or requires accounting standards in preparation of financial statements. Some laws require GAAP to be applied. However, in all cases, GAAP is not defined. For auditing standards, in the year 2003, OFAG directed all auditors to conduct audits in compliance with ISA. However, the directive met resistance from auditors. One of the arguments for resistance by the auditors was that it is impossible to apply ISA in the absence of accounting standards. The directive was subsequently withdrawn.

33. **Every auditor determines accounting standards for their clients.** Most institutions follow advice of their auditors on how to prepare financial statements. Most auditors also tell their clients how to prepare financial statements. It appears therefore that auditors determine accounting standards for their clients.

34. **Every auditor determines their own standards.** In the absence of practical authoritative guidelines, auditors use their knowledge and best endeavors in conducting audits. Some apply ISA, while others apply generally accepted auditing standards.

#### **E. Enforcing Accounting and Auditing Standards**

35. **The Commercial Code provides for punishment of auditors for failing to deliver their obligations.** The Commercial Code states that an auditor shall be punished for knowingly confirming an untrue report concerning the position of the company; and for failing to inform the public prosecutor of an offense that is known to have been committed. The punishment for these offences is provided in the Penal Code. For the first offense, the punishment is a fine not exceeding Br20,000 and rigorous imprisonment not exceeding 10 years. For the second offense, the punishment is a fine of Br500 or 3-month imprisonment.

36. **There are no set penalties for noncompliance with the requirements on accounting and financial reporting.** In the Commercial Code, there are no penalties for noncompliance with provisions for keeping accounting records, preparing financial statements, or filing and publication of the financial statements. Likewise the laws and regulations for banks, insurance companies, state-owned enterprises, and NGOs have no penalties for noncompliance with accounting and other annual financial reporting requirements.

37. **The Central Commercial Register at the Ministry of Trade and Industry has capacity constraints.** The Central Commercial Register has serious capacity constraints and is having to rely on the Federal Inland Revenue Authority for information on renewing business licenses. The Authority's own database is not orderly. The ROSC team was unable to get the breakdown of companies registered into the numbers of share companies, private limited companies of not more than 20 members, and private limited companies of more than 20 members. There is no enforcement of filing requirements set in the Commercial Code because of capacity constraints.

38. **There is lack of capacity in all regulatory institutions to deal with accounting and auditing matters.** The regulatory bodies for financial institutions, state-owned enterprises, and NGOs do not have expertise to effectively deal with technical accounting and auditing matters in their regulation. Most regulators do not have professional accountants to analyze accounts prepared in accordance with IFRS and audited in accordance with ISA for public interest entities falling under their regulation. The only capacity the regulators have is to deal with the specific sector requirements.

39. **There is no mechanism providing assurance on the quality of work being conducted by auditors.** With absence of a program for quality review of auditors, there is no mechanism for ensuring that auditors conduct their work diligently.

### III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

40. **The accounting practices in Ethiopia vary among institutions and differ from IFRS.** In a sample of 35 sets of audited financial statements, 17 indicated that they applied IFRS, 10 applied GAAP (not defined), while 8 did not indicate applying any principles or standards. The sample of 35 sets of audited financial statements comprised 7 banks (2 state-owned), 6 insurance companies (1 state-owned), 2 microfinance institutions, 1 privately owned share company, 17 other state-owned enterprises, and 2 NGOs. All 35 financial statements were analysed by the ROSC team by comparing with IFRS requirements. Some noted specific differences are documented below.

41. **The following are selected differences between accounting practices in Ethiopia and IFRS requirements.** The ROSC review focused on issues of presentation and disclosure only, not issues of recognition and measurement, which are not detectable through a review of financial statements requirements:

- **IAS 1, Presentation of financial statements.** Contrary to the requirements of IAS 1, 21 financial statements did not include a statement of changes in equity; 19 out of 20 nonfinancial institutions did not appropriately separate current and noncurrent items in the balance sheet.
- **IAS 2, Inventories.** Fifteen financial statements stated that actual capacity was used to allocate overheads. IAS 2 requires the use of normal capacity in allocating overheads.
- **IAS 7, Cash flow statement:** Contrary to IAS 7, 2 financial statements for NGOs did not have a cash flow statement as an integral part of the financial statements; 8 financial statements did not reconcile cash and cash equivalents in the cash flow statement to the amounts in the balance sheet.

- **IAS 10, Events after balance sheet date.** Twenty-three financial statements did not disclose the date on which the financial statements were authorized for issue; IAS 10 requires the disclosure.
- **IAS 21, Income Taxes.** Contrary to IAS 21, 23 financial statements did not include deferred income tax in their financial statements.
- **IAS 16, Property, plant and equipment.** Except for one, in all the financial statements there was no disclosure of carrying out impairment review for property, plant and equipment as required by IAS 16.
- **IAS 17, Leases.** Five financial statements recognized leasehold land as finance lease but failed to apportion lease payments between the finance charge and the reduction of the outstanding liability as required by IAS 17.
- **IAS 19, Employee benefits.** None of the financial statements had adequate disclosures on employee benefits in comparison to the requirements of IAS 19; 8 financial statements only disclosed that the company has a defined contribution pension scheme.
- **IAS 21, The effect of changes in foreign exchange rates.** Twenty-six financial statements did not make disclosures about foreign exchange rates as required by IAS 21.
- **IAS 24, Related party disclosures.** Contrary to the requirements in IAS 24, 33 financial statements, including all financial institutions, did not have disclosures such as the relationship and transactions, pricing policies, the volumes of related party transactions, and the corresponding amounts. All entities did not disclose information such as retirement benefits and compensation paid to key management personnel. Adequate disclosure of material related party relationships and transactions is essential to users' understanding of entities' financial position and results, and for minority investors' confidence that they will receive a fair treatment.
- **IAS 32, Financial instruments presentation.** Two financial statements did not exhibit the classification of financial instruments as financial liability or equity as required by IAS 32.

#### IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

42. **Auditing standards vary among the auditors and between engagements.** In a sample of 35 audited financial statements, 17 of the independent auditor reports stated that the audit was conducted in accordance with ISA, 18 in accordance with generally accepted auditing standards (not defined). In addition, 5 audit firms conducted audits alternatively in accordance with ISA or generally accepted auditing standards.

43. **There is no mechanism of checking the actual standards practiced.** In ROSC-conducted interviews, auditors indicated that they have up-to-date knowledge on procedures for audits (and seemed to be knowledgeable of ISA requirements, including terms of audit engagements, quality control, documentation, planning, audit evidence, among other). The auditors also indicated that they apply the best standards when conducting the audits. This is not withstanding the fact that they complained that audit fees are very low and may not cover costs of a good standard audit. However, in the absence of quality reviews, there is no mechanism of checking the actual practices of auditors.

44. **Ethiopia has only two audit firms at partnership level, the other audit firms are sole practitioners.** Of the country's total 58 audit firms, the 2 partnerships have 3 partners

each and 56 firms are sole practitioners. This set up of the audit profession means that most of the audit firms cannot meet the internal quality review requirements in international good practice, which require a second/concurring partner review.

45. **The Audit Services Corporation (ASC), a totally government-owned corporation, audits state-owned enterprises.** The ASC-audited enterprises include state-owned banks. Although the ROSC team observed that the Audit Services Corporation operates independently without Government influence, the related parties set up in this case would affect the extent to which the firm is seen as independent.

## V. PERCEPTION ON THE QUALITY OF FINANCIAL REPORTING

46. **There is a lack of appreciation of the role of quality financial reporting by the business community.** Stakeholders indicated that there is lack of appreciation of good quality financial reporting by the business community. Most people in the business community are not aware of the importance of good quality financial reporting and the purpose it would serve.

47. **Appointment of auditors is usually through bidding process with hardly any regard to technical expertise.** Most auditors complained that the audit fees in the country are very low, mainly caused by a practice where most appointments for auditors are done through a bidding process, with little or no regard of professional expertise. This is indicative of little appreciation of high quality audit services.

48. **Banks do not rely on financial statements for lending.** The lending culture is largely based on collateral security. If anything, financial statements play a small secondary role.

49. **Tax authorities and businesses do not easily agree on the financial statements for tax purposes.** Business people indicated that tax authorities do not trust their financial statements. Tax authorities on the other hand stated that they encounter financial statements prepared on a wide range of bases, mostly indicating the businesses' lack of understanding of the tax law. This situation is inefficient and burdensome to both parties as there has to be a lot of vouching by the tax authorities and a lot of negotiations between the parties.

## VI. POLICY RECOMMENDATIONS

50. The policy recommendations in this section are mutually supportive, therefore they require holistic, multi-disciplinary approaches for implementation. Implementation will require the cooperation of a wide range of stakeholders including the Government, regulators, captains of industry, academics, and the accountancy profession, and need to be championed by a senior Government official. The Government, policymakers, and development partners should work together to secure the resources in order to achieve a strong financial reporting infrastructure in Ethiopia. The recommended policy reforms are set out in the following paragraphs.

51. **Ethiopia should establish a National Steering Committee (NSC) to coordinate the financial reporting and auditing reforms.** The NSC should advise policymakers and

regulators regarding implementation of the recommendations. Based on the successful experience of other countries, the ROSC team recommends that the NSC should develop a detailed country action plan that sets clearly sequenced key actions and allocates responsibilities for implementing the necessary reforms. The plan should indicate the resources necessary for successful implementation.

52. **The statutory framework should be improved.** The overall framework should bring requirements for accounting and auditing up to date with good international practices; enhance mechanisms for enforcement of financial reporting requirements; enhance the oversight of audit and assurance services; and enact a dedicated law and establish dedicated institutions for regulation of the accountancy profession.<sup>20</sup>

53. **Revise the Commercial Code and the laws and regulations for banks, insurance companies, state-owned enterprises, and nongovernmental organizations.** The revised Code should include the following:

- Require the entities to prepare financial statements in compliance with accounting standards.<sup>21</sup>
- Require the entities to appoint auditors properly qualified in terms of holding a practicing license issued in accordance with the country's regulations on accountancy.
- Require auditors to provide audit services in accordance with the requirements of auditing standards and other related pronouncements.
- Set appropriate penalties for failure to comply with all accounting, auditing, and financial reporting requirements.
- Require statutory audit for all limited liability companies, whether they are share companies or private limited companies.<sup>22</sup>
- Remove the requirement for companies to appoint more than one auditor.
- Provide regulation for issuance of shares to the public i.e., establish a legal requirement of an audit report on the financial information contained in the prospectus; and registration, and approval of the prospectus, with a regulator, before release to the public.

54. **Enact a financial reporting law.** The law should include the following:

- Establish the National Accountants and Auditors Board and a strong professional body.
- Set the rules for regulating the profession including licensing of auditors and monitoring and disciplining of professional accountants.
- Set the rules for accountancy training and awarding of the local accountancy professional qualifications.

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<sup>20</sup> Market sophistication, with increased financial risks and resultant need for enhanced regulation, has necessitated dedicated institutions supported by a dedicated law for regulation of accountancy. Examples of this law include Mauritius's Financial Reporting Act (2004), South Africa's Auditing Profession Act (2005), Kenya's Accountants Act (1977), Nigeria's draft Financial Reporting Council Act, and Botswana's draft Financial Reporting Act.

<sup>21</sup> In all cases in these policy recommendations, the accounting and auditing standards should be defined as those promulgated by the country's authority responsible for setting accounting and auditing standards. In this case the National Accountants and Auditors Board (when established) would issue the accounting and auditing standards and update them in line with changes in internationally accepted standards.

<sup>22</sup> Some of the largest private sector corporate entities in the country are private limited companies and are not required to have statutory audit of annual financial statements.

55. **Establish a National Accountants and Auditors Board.** This should be established under the new financial reporting law. Administratively, the National Accountants and Auditors Board should report to a particular government agency but should be fully accountable to the legislature. The composition of the governing board of directors should include accounting and auditing specialists, Government officials, and other persons of good professional standing in the society (academics, retired practitioners, etc). The National Accountants and Auditors Board should have complete independence from the professional body; there should be no domination of practicing accountants and auditors in the governing board.<sup>23</sup> The Board's functions should include:

- Setting accounting and auditing standards.
- Licensing of auditors and authorized public accountants in practice. One of the conditions for NAAB to issue the practicing license should be satisfying the competence and capability requirements as set by the professional body.
- Conducting audit practice review and monitoring and enforcing accounting and auditing requirements in the case of public interest entities.
- Providing independent oversight of the regulation of the profession (overseeing the professional body).

The functions of National Accountants and Auditors Board should be executed in close collaboration with the other regulators and the professional body. The Board should collaborate with the other regulators (e.g. OFAG, Central Commercial Register, National Bank of Ethiopia, Privatization and Public Enterprises Supervising Agency, and Disaster Prevention and Preparedness Agency) on matters of defining financial reporting, accounting and auditing requirements for particular institutions, and enforcement of the same. The National Accountants and Auditors Board should collaborate with the professional body in its functions of setting accounting and auditing standards, licensing of auditors, as well as overall regulation of the profession. Ideally the National Accountants and Auditors Board should set accounting and auditing standards for both the corporate and public sectors.

56. **Issue accounting and auditing standards.** This should be done by National Accountants and Auditors Board as the authority responsible for setting accounting and auditing standards in the country. In this function, National Accountants and Auditors Board should collaborate with the professional body and other stakeholders. The accounting standards to be issued should be based on international experience:

- ***IFRS should be adopted as accounting standards for all public interest entities.*** Public interest entities should be clearly defined by National Accountants and Auditors Board in consultation with stakeholders.
- ***Simplified financial reporting standards should be adopted or set for small and medium enterprises (SME).*** Entities, which do not fall into the definition of public interest entities<sup>24</sup>, will fall into the SME category. There is international acceptance

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<sup>23</sup> For example, in South Africa's Independent Regulatory Board for Auditors, not more than 40 percent of the board members can be registered auditors; and in the US Public Company Accounting Oversight Board, not more than 40 percent of the board members can be professional accountants.

<sup>24</sup> Public interest entities are defined by the nature of their business, size, and number of employees; or by their corporate status by virtue of their range of stakeholders. Examples may include listed companies, banks and similar financial institutions, insurance companies, and large enterprises. To be considered a public interest entity, the large enterprises may be defined as individual enterprises and groups of enterprise that meet any two of the following three thresholds: (a) total number of employees exceeding [a number to be decided in consultation with the country stakeholders]; (b) total assets on the balance sheet exceeding [amount to be decided in consultation with stakeholders]; and (c) total turnover exceeding [amount to be decided in consultation with stakeholders].

that small and medium enterprises require simplified financial reporting standards fitting their reduced size and narrow stakeholder base. The International Accounting Standards Board is in the process of setting simplified accounting standards, which can be adopted or adapted for the small and medium enterprises in Ethiopia.

- ***ISA should be mandated for all corporate sector audits.*** Audit procedures do not really differ with circumstances, therefore ISA should be applicable to all audits.

In parallel, the National Accountants and Auditors Board should also issue accounting and auditing standards for the public sector. In issuing standards for both the corporate and public sectors, the National Accountants and Auditors Board could usefully draw on the ongoing and completed work being done by the Addis Ababa Chamber of Commerce and Sectoral Association and the Ethiopia Civil Services College.

57. **Establish a strong professional accountancy body.**<sup>25</sup> The professional body should have legal grounding in the financial reporting law and should work toward having IFAC membership. The legal grounding will make it possible for the body to carry out certain self-regulatory functions in line with IFAC pronouncements and help the body in instituting and sustaining standards comparable to international good practices. As a condition for getting an audit license, all auditors must be members of the professional body. Measures should be taken to ensure that the professional body has enough technical and human resource capacity for its functions. This in turn will allow the professional body to establish the due processes, programs and activities to satisfy IFAC's membership requirements as described in the Statements of Membership Obligations and represent the needs of the profession. In terms of knowledge for its organizational development, a twinning arrangement with a well-established professional body should be established. The professional body should:

- Work closely with the National Accountants and Auditors Board in setting accounting and auditing standards for the country, and in regulating professional accountants.
- Set competence and capability requirements for auditors and authorized accountants in public practice.
- Institute a quality assurance program for auditors and authorized public accountants in practice in collaboration with National Accountants and Auditors Board. In this regard the professional body shall continuously disseminate information regarding: proposed standards, new standards and application of the standards; provide necessary training for practical application of the standards; assist members to enhance their capabilities in areas identified by the external quality reviews conducted by NAAB; and handle investigative and disciplinary matters, arising from the external quality reviews conducted by NAAB.
- Adopt the IFAC Code of Ethics for Professional Accountants and have proper procedures for handling investigative and disciplinary matters.
- Organize CPD courses and make CPD compulsory in accordance with IFAC guidelines (at least 30 hours per annum or at least 90 hours in a three-year period).
- Serve the interests of its members.
- Administer a local accountancy profession (discussed below), including controlled practical training programs.

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<sup>25</sup> The need for a strong professional body is reiterated by OFAG in the introduction to the Code of Ethics, which OFAG issued in January 2004. OFAG states that it is assumed that professional accountants adhere to the standards by the professional bodies to which they are members. However, the foreign-based bodies are logistically unable to follow their members practicing in Ethiopia.

There is broad consensus among stakeholders in Ethiopia that there should be one professional accounting body in Ethiopia which trains and certifies accountants and auditors for both the public and private sectors. The benefit for this set up, common to many emerging and developing economies, include: efficiencies; adequate utilization of scarce technical and human resources; and avoidance of the movement of skills and knowledge from the public sector to the private sector as privatization occurs. However, there are unique skills and knowledge required for the public sector versus the private sector. Therefore, stakeholders will need to ensure that the professional body is resourced adequately to deliver services to satisfy the requirements or unique skills required for each of the sectors. The specific location of the professional body can be further discussed and finalized by the various stakeholders. This should aim to bring together the different existing institutions and initiatives e.g., the EPAAA, the ICAA (under the Ethiopia Civil Services College).

58. **Establish a local professional accountancy qualification.** The local qualification will assist in increasing the number of professional accountants in the country. The standards of the qualification should be set at a level comparable to reputable international professional accountancy qualifications. A national professional accountancy body of an industrialized country, which awards a reputable professional qualification, should be engaged to provide technical expertise for ensuring that the qualification meets international standards. The syllabi should include IFAC requirements on education and should always be regularly updated with new pronouncements by IFAC on education. The accountancy (and auditing) qualification would need to cater to both professional and technician levels. Again both corporate and public sectors would need to be covered. Although the nature of education and qualifications for these streams may be different in some aspects, there is a lot of common ground and these need to be well coordinated.

59. **Exploit regional and international collaboration opportunities for delivering the functions of NAAB and the professional body.** Initially NAAB and the professional body may not have the capacity to execute all its functions or indeed it may not be efficient to institute some of the capacity to cater for only the local economy. Examples of functions which may benefit from regional and international collaboration include setting of accounting and auditing standards; practice review of auditors; and setting of code of Ethics. In this regard, the country should exploit the opportunities for delivering these functions available in the region, through ECSAFA and internationally-through IFAC. NAAB and the professional body should exploit the said opportunities while ensuring that the local conditions in Ethiopia are well regarded.

60. **Assist universities and colleges to update their curricula and use up-to-date teaching materials with good international practice.** Universities and colleges offering degrees and diplomas should be assisted to upgrade their curriculum to a level that will prepare graduates for the enhanced requirements in accounting and auditing. The curriculum should include accounting standards, auditing standards, and professional and business ethics. The same technical assistance providers involved in developing the local accountancy profession can provide technical assistance to the universities and colleges for upgrading the curriculum. To support the new curriculum, the training institutions should be assisted with up-to-date textbooks, copies of accounting and auditing standards, and training-of-trainers programs on practical application of IFRS and ISA.

61. **Assist higher educational institutions to retain qualified lecturers.** Assistance should be provided through improving the remuneration to competitive levels as well as increasing exchange programs with other international educational institutions. Support for putting this into effect should be sought from the Government, the private sector, as well as the country's development partners. Retaining qualified lecturers will feed into producing capable graduates, as well as help the country in having quality education and research capabilities for further development of accountancy profession.

62. **Enhance the capacity of all regulators.** Effective enforcement mechanisms are essential for achieving high-quality financial reporting. The capacity of all regulators should be reviewed. Where necessary, the capacity should be enhanced to enable the regulators effectively handle their responsibilities and handle IFRS-related issues in the regulated entities.

- ***The Central Commercial Register.*** The Register should have sufficient capacity to track the corporate entities' compliance, or lack of it, with the provisions of the commercial code, on a timely basis. Appropriate technology to enable efficient filing and retrieving of documents will be essential in this regard. The staff in the Registry will also need to have up-to-date knowledge of the developments in financial reporting requirements.
- ***National Bank of Ethiopia.*** The National Bank requires adequate staffing to handle and track the compliance of all financial institutions with financial reporting requirements. The National Bank of Ethiopia should also have capacity and expertise to handle IFRS issues relating to the financial institutions. Implementation of prudential regulations in financial institutions closely interacts with IFRS issues. Unless there is an understanding of IFRS issues by both the regulator and the banks and other financial institutions, difficulties will be experienced in reconciling IFRS and regulatory requirements.
- ***Privatization and Public Enterprises Supervising Agency and Disaster Prevention and Preparedness Agency.*** These regulators for state-owned enterprises and NGOs should also have adequate staffing and appropriate technology to enforce financial reporting requirements of their particular entities.

63. **Ensure co-ordination of all regulators.** All regulators should closely co-ordinate with regard to financial reporting matters so that specialized expertise can be accessed when unavailable in some institutions. In particular, all regulators may not have expertise to deal competently with IFRS issues. But this expertise could be accessed by all regulators from the National Accountants and Auditors Board. These arrangements can be developed through a memorandum of understanding between the National Accountants and Auditors Board and the regulators.

64. **Conduct awareness campaigns and related programs.** The objective of the programs should be to ensure that the enhanced financial reporting requirements are well understood, and that there is capacity for the implementation of new requirements. Well-planned transition arrangements and good timing for launching the awareness campaign would be essential. The programs should be specifically targeted for the following groups:

- ***The business community.*** The business community should be fully aware of the usefulness of quality financial reporting, and the changes happening locally in financial reporting requirements together with the international developments. The business community should also be aware that financial reporting requirements are

not a matter of choice but of law, therefore compliance will be compulsory and noncompliance will have penalties.

- **Directors of companies.** Company directors should be fully aware of their responsibilities in preparation, audit, and filing of financial statements; and the new requirements with its enhanced enforcement mechanisms. They should also know the necessity for their organizations to acquire the appropriate expertise in meeting the new requirements.
- **Directors of finance.** Finance directors should be fully aware of the requirements for preparation of financial statements. Training programs should be instituted to assist them in the upgrading of their knowledge for handling IFRS and accounting standards. The trainings should be separately targeted for those in public interest entities, small and medium enterprises, and the banking and insurance sectors.
- **Auditors.** Auditors should be fully aware of the requirement for all audits to be conducted in compliance with ISA. Training programs should be arranged to ensure all auditors acquire knowledge for applying ISA. Audit manuals for guidance in practically dealing with ISA should be produced and distributed to all auditors.
- **Universities and colleges.** Higher education institutions should be fully aware of the upcoming changes in accounting and auditing requirements. They should be assisted in upgrading their curricula to produce graduates who will feel comfortable handling the new requirements. Programs to assist instructors upgrade their own knowledge should be undertaken.
- **Tax authorities.** Tax authorities should be made fully aware of the new financial reporting requirements and its enhanced quality control and enforcement mechanisms to help them develop confidence in audited financial statements. They should be assisted in acquiring the skills to understand and deal with the financial statements prepared on the basis of IFRS and other applicable accounting requirements. This will assist in making the tax assessments of corporate entities efficient.
- **All regulators.** All regulators should be made fully aware of the objectives of upcoming improvements in financial reporting requirements and their critical role of enforcing requirements within the system.

## Appendix A.

### Comments on Commercial Code 1960 and Draft Revised Commercial Code

<i>Subject</i>	<i>Commercial Code 1960</i>	<i>Draft revised Commercial Code</i>	<i>Good practice for consideration</i>
<b>Preparation of financial statements - compliance with accounting standards</b>	Article 63: Any person or business organization carrying on trade <u>shall keep such books and accounts as are required in accordance with business practice and regulations</u> , having regard to the nature and importance of the trade carried on.	Article 63: Any person or business organization carrying on trade shall keep, <u>according to generally accepted principles of accounting</u> , such books and accounts as required in accordance with business practice and usage, having regard to the nature and importance of trade carried on.	Require companies to prepare financial statements in compliance with accounting standards as promulgated by country's authority responsible for setting accounting and auditing standards. (The authority should then set accounting standards; IFRS for public interest entities and simplified accounting standards for SME.)
	Article 448: (1) The balance sheet and profit and loss account shall be prepared each year in the same form as in the preceding years and the methods of valuation shall remain the same unless the general meeting adopts variations in the mode of presentation of the accounts or the methods of valuations on the reasoned advice of auditors. (2) The profit and loss shall show under separate heads losses or profits arising out of the company's various activities.	Article 448: (1) The balance sheet and profit and loss statement shall be prepared each year in the same form as the preceding years and the methods of valuation shall remain the same, unless the general meeting adopts variations in the mode of presentation of the accounts or the methods of valuation on the reasoned advice of the auditors. (2) The profit and loss statement shall show under separate heads losses or profits arising out of the company's various activities	
<b>Preparation of financial statements - make up of financial statements</b>	Article 446: (1) At the end of each financial year, the directors shall prepare a detailed inventory and valuation of assets and liabilities (2) <u>They shall draw up a balance sheet and a profit and loss account</u> and prepare a report on the state of the company's activities and affairs during the previous year. (3) The report shall give detailed information on the profit and loss account, an exact statement of the total amount of remuneration for directors and auditors and proposal for distribution of dividends if any.	Article 446: (1)At the end of each financial year, the directors shall: (a) prepare a detailed inventory and valuation of assets and liabilities (b) <u>draw up a balance sheet and profit and loss statement</u> and prepare a report on the state of companies activities and affairs during the last financial year. (2) The report specified in sub-article 1(b) shall give detailed information on the profit and loss statement, an exact statement of the total amount of remuneration of the directors and auditors and proposals for distribution of dividends, if any.	Leave the composition of the financial statements to be defined by the accounting standards. In any case, accounting standards define the composition of financial statements.

<i>Subject</i>	<i>Commercial Code 1960</i>	<i>Draft revised Commercial Code</i>	<i>Good practice for consideration</i>
<b>Duties of auditors – compliance with auditing standards</b>	<i>Not provided</i>	Article 374: (1) The auditor shall carry out his duties with due regard to <u>generally applicable accounting (sic) principles</u> . He shall give accurate information and serve the interest of shareholders without bias.	Require auditors to conduct their duties in accordance with auditing standards as promulgated by the country’s authority responsible for setting accounting and auditing standards. (The authority should then mandate ISA on all auditors).
<b>Qualification of auditors</b>	<i>Not provided</i>	<i>Not provided</i>	Provide for qualification of auditor or(s) as only person(s) holding a practicing license issued in accordance with the country’s regulations of the accountancy profession.
<b>Audit requirement for private limited companies (more than 20 members)</b>	Article 538: (1) Where a company consists of more than twenty members, not less than three auditors shall be appointed in the memorandum of association	Article 538: (1) Where a company consists of more than twenty members, not less than three auditors shall be appointed in the memorandum of association.	Require large private limited companies (those qualifying as public interest entities) to appoint an auditor.
<b>Appointment of auditors (more than 1 member)</b>	Article 538 (1) as above Article 368: (1) The general meeting of every company limited by shares shall appoint one or more auditors and one or more assistant auditors	Article 538 (1) as above Article 368: (1) The general meeting of every company limited by shares shall elect one or more regular or one or more alternate auditors.	Require appointment of auditor (one auditor).
<b>Formation of a share company by public subscription</b>	Art 317-322 <i>No regulation provided</i>	Art 317 -322 <i>No regulation provided.</i>	Provide for regulation by requiring that: - There should be an audit opinion of the financial information included in the prospectus. - The prospectus should be registered with the Commercial Register and should be approved by the commercial registrar before issuing to the public.